



Capital Market Reforms

Chile's domestic capital market includes over US\$50 billion in assets. Chile's privatized social security system represents the largest institutional investor, with US\$40 billion in assets. The mutual funds industry, with assets of US\$5 billion, is growing more than 20% annually, while the factoring industry is also experiencing double-digit growth on an annual basis.

Market Overview

► In 1974 and 1975, the first generation of capital market reforms in Chile freed up interest rates and credit controls. Between 1974–1981 the Chilean financial system grew significantly thanks to a liberalization process that ended 30 years of financial restriction. In the early 1980s Chile embarked on a second generation of capital market reforms, significantly increasing the powers of supervision and control of the Superintendence of Banks and Financial Institutions (SBFI) and introducing an improved regulatory platform. These reforms have allowed the Chilean capital market to grow remarkably in size, depth, and liquidity, transforming it into arguably the most developed in Latin America.

Chile's Annual GDP	US\$70 billion
Stock Exchanges (% of total market's volume)	Santiago Stock Exchange (80%) Electronic Stock Exchange (18%) Valparaiso Stock Exchange (2%)
Listed Shares (All national exchanges)	601 Listed Stocks
Individual Shareholders	600,000 (4% of the population)
Total Market Capitalization (Dec. 31, 2003)	US\$87.6 billion

Capital Market Reforms I

In 2001 the Chilean government launched a “three-pillar” capital market reform project (Spanish RMC I), designed to deregulate the country's capital markets to stimulate domestic savings and economic growth. The three pillars were tax, institutional, and pension fund measures.

The RMC I reforms focused on the following areas:

- 1. The tax reforms affecting employees and independent taxpayers include:
 - Increase in the limit for voluntary pension fund contributions from 48UF to 50UF per month (the UF —Unidad de Fomento— is an inflation-adjusted index, adjusted daily. 1 UF approx. US\$29)
 - Elimination of the capital gains tax (15%) on:
 - the sale of high-volume traded stocks and securities purchased through the stock exchange
 - the sale of stock of companies for three years after the IPO
 - the short selling of stocks and bonds on the stock market
- 2. The institutional reforms directly influencing pre-tax voluntary savings include:
 - The deregulation of the insurance industry with reforms that ease limits on an insurance company's investment portfolio, allow for new investment products, and introduce new disclosure and solvency requirements
 - The deregulation of mutual funds with reforms that simplify the trading of shares, allow mutual fund managers to develop “complementary activities,” and standardize capital requirements
 - The creation of a new assets-management entity called a “general fund administrator” that can be established to manage multiple types of funds—including mutual funds, investment funds, and mortgage companies
- 3. The pension fund reforms allow pension fund administrators (Spanish AFPs) to offer five investment choices, improving the previous law that permitted just two options.

In summary, RMC I resulted in increased domestic savings, improved market liquidity and depth, facilitated the access to capital markets for emerging companies (equity financing), and allowed banks and insurance companies to compete on equal terms with pension funds, thus stimulating competition in the local market.

Chile's AFPs managed US\$600 million in voluntary savings as of October 2003. The pension fund regulatory authority projects that the RMC I will increase voluntary savings to US\$1 billion in the next four years.

Capital Market Reforms II

In June 2003, Chile's government presented the second phase of recent Capital Market Reforms, or CMR II. These reforms hope to make Chilean capital markets even more competitive by further modernizing and simplifying financial system operations. The plans for a voluntary savings system with features similar to 401(k) plans in the U. S. are included in this second phase of reforms.

CMR II covers six main elements:

▶ 1. Stimulation of the venture capital industry.

In order to increase the supply of entrepreneurs with good ideas and solid projects, the proposed reform includes a temporary exemption from capital gains tax. This exemption, which will be subject to some minimum requirements, will be capped at approximately US\$240,000. Profits arising from tax-exempt income, distributed to an investment fund's shareholders, will also be exempt from taxation.

▶ 2. Reductions in transaction costs.

The proposed reform will allow for the creation of a Limited Liability Corporation, providing a dynamic and flexible structure, adapted to the needs of the venture capital industry. In an effort to reduce financing costs and improve market information, the use of assets as collateral will be introduced to foster greater flexibility and create a national register of assets used for this purpose. Many small and mid-sized companies in Chile depend heavily on the use of collateral and guarantees in order to access financing at competitive rates.

▶ 3. Improved corporate governance standards.

The proposed reform seeks to bring Chilean legislation on corporate governance in line with OECD (Organization for Economic Cooperation and Development) standards. As a result, it includes improvements to existing regulation in areas such as disclosure of information, voting rights, transactions between related parties, insider trading and supervision.

▶ 4. Improvements in supervision and enforcement.

These proposed initiatives include improved control of operational risks and increased levels of transparency in the securities industry; measures to encourage the electronic (rather than physical) issue and trading of high-value securities; higher minimum capital requirements for financial intermediaries; and increased self-regulation by stock exchanges. The proposed reform also broadens the criteria that will be taken into account by the regulatory authorities when considering applications for licenses to operate banks, life insurance companies and pension funds (AFPs). In addition, it will increase regulatory powers vis-à-vis changes of control and major stock transactions.

▶ 5. Improved voluntary savings mechanisms.

The proposed reform includes mechanisms to complement existing voluntary pension-savings alternatives, thus opening the way to collective plans in which both employers and employees will be able to contribute. Employers' contributions will be considered as a tax-deductible expense.

▶ 6. Updating legal texts.

This proposed reform will bring legal texts inline with current practice in capital markets.



Other Resources

- ▶ Chilean Central Bank, www.bcentral.cl
- ▶ Chilean Securities and Exchange Commission, www.svs.cl
- ▶ Chilean Pension Fund Superintendency, www.safp.cl
- ▶ Bank and Financial Institution Superintendency, www.sbif.cl



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